CHAPTER **6**

Understanding Expenses

Chapter Objectives

- Appreciate all the various expenses that affect a sport enterprise.
- Distinguish where expenses come from for sport enterprises.
- Understand the various sources of expenses for organizations in the professional sport industry.
- Explain sources of expenses for intercollegiate sport and other amateur sport organizations.
- Interpret the various sources of expenses for sporting goods companies and other sport organizations.

Expenses and Debt

- **Expenses—Costs incurred by an organization to operate**
  - **Rent, utilities, insurance, salaries, benefits**
  - **Industry dependent**
  - **Fixed expenses exist regardless and are highly predictable over future periods**
- **Debt—Accrued costs and expenses owed to others**
  - **Used for long-term capital costs where organization does not have revenue on hand to cover large expenses**

Expenses in the Sports Industry

- All expenses need to be examined carefully
  - Takes money to make money
- Organizations face constantly rising costs
- Various expenses
  - Personnel costs are one of the largest for most sport organizations
    - Professional sports: Player salaries
    - Intercollegiate sports: Grants-in-aid

Expenses in Professional Team Sports: Player Expenses

- Two segments: major leagues and minor league affiliates
- Minor leagues
  - Parent major league club incurs costs for players' salaries, coaching salaries, and benefit expenses for affiliate teams (MLB)
  - Some minor leagues are not affiliated and must cover player and coach expenses themselves
- Minor league players earn dramatically less than their major league counterparts
- Player expense often makes up 50% of total operating costs for major sports teams

Expenses in Professional Team Sports: History of Player Expenses

- **Prior to 1970s**
  - **Players competed under reserve clause where team owned rights to player for entire career unless not offered a contract**
- **After 1970s**
  - **Free agency system through legal action or collective bargaining between player unions and team owners**
- **Collective Bargaining Agreement (CBA)**
  - **Agreement that governs the relationship between players and owners and covers all areas related compensation, health and retirement benefits, drug testing, and free agency**

Expenses in Professional Team Sports
Player Expenses: The Salary Cap

- **Negotiated salary system—Team salary cap, player salary cap, and luxury taxes**
- **Owners tie player costs to league revenues through a salary cap**
- **Luxury tax—Tax collected from teams who spend over the salary cap that is distributed to teams under cap and other player benefits**
- **Various leagues have different methods for determining luxury taxes**

Expenses in Professional Team Sports Player Expenses: The Salary Cap and Luxury Tax

Table 6.2 Major League Baseball Luxury Tax System

Year	Payroll amount (in millions)	% Tax 1st offense	% Tax 2nd offense	% Tax 3rd offense	% Tax 4th+ offense
2017	$195	20	30	50	50
2018	$197	20	30	50	50
2019	$206	20	30	50	50
2020	$208	20	30	50	50
2021	$210	20	30	50	50

Source: Competitive Balance Tax (2018).

Expenses in Professional Team Sports: International Professional Sports

- **Many international professional sports leagues have no salary cap or luxury tax system**
- **Top leagues in European soccer spend lavishly on player payroll**
- **Leads to disparity between high spending and financially weaker clubs**

Expenses in Professional Team Sports: Other Team Expenses

- Additional labor costs (e.g., scouts, front office staff in various roles)
- Two parts of organization
  - Business operations—Staff across variety of business roles from marketing and finance to sales
  - Team operations—Overseen by general manager who manages coaches, scouts, medical specialist, and player development staff
- Business operations is vitally important for generating revenues.

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Expenses in Professional Team Sports
Other Team Expenses *(continued)*

- **Game-day operations (e.g., staff of ushers, ticket takers, security guards) that allow home events to occur smoothly**
- **Often part-time low-wage workers**
- **Significant expense given the number of workers needed**
- **Often outsource activities to contractors**
  - **Examples: Aramark, CSC, Levy, etc.**
  - **Reduces cost because third party deals with hiring, training, and compensation**

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Expenses in Professional Team Sports
Other Team Expenses *(continued)*

- **Expense example: parking attendants at major sporting event**
  - **Stadium size = 60,000**
  - **Number of parking spaces = 15,000**
  - **Number of parking attendants = 100**
  - **Average pay per hour = $15**
  - **Number of hours worked per event per attendant = 4**
  - **Total parking attendant wage cost = $6,000**

Expenses in Intercollegiate Athletics

- **Intercollegiate athletics are part of larger university organization.**
- **Some expenses related to operations may be covered by other university departments (e.g., facilities, maintenance, concessions).**
- **Expenses exist, but the athletic department doesn’t pay for them.**
- **There are no generally accepted accounting practices (GAAP) for universities.**

Expenses in Intercollegiate Athletics: NCAA Regulations

- **Primary intent of rules is to help ensure competitive balance, emphasize education mission, and promote ethical conduct.**
- **Rules also minimize expenses.**
- **Limit season length, practice time, and games played.**
- **Restricts recruitment and coaching staff and accompanying costs**

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Expenses in Intercollegiate Athletics NCAA Regulations *(continued)*

- **Grant-in-Aid—Covers tuition, housing, and books, and possibly includes cost-of-living payments**
- **NCAA limits the number of scholarships according to sport and division level**
  - **Used to balance on-field competition and minimize expense**
- **Often scholarships do not provide full benefit**
  - **Many Division II programs and Olympic sports (e.g., swimming, golf, tennis) offer partial scholarships.**

Expenses in Intercollegiate Athletics: The Players

- **Players are not permitted to be paid a salary for performing on the field.**
- **Student are permitted to receive grant-in-aid or an athletic scholarship.**
- **Title IX has increased spending in women's sports and the expenses associated with them.**

Expenses in Intercollegiate Athletics
Other Expenses

Table 6.6 Median Selected Expenses for NCAA Division I (FBS) Institutions, 2015

Source	Total $ expenses (in millions)	% Increase since 2006
Salaries and benefits	22.84	102.50
Grants-in-aid (scholarships)	9.27	59.88
Facilities maintenance	7.52	192.72
Team travel	4.17	69.65
Game expenses	2.24	76.52
Recruiting costs	1.05	55.55
Fund-raising expenses	1.26	32.21
Guarantees and options	1.36	44.68
Equipment, uniforms, and supplies	1.76	90.89

Source: Fulks (2016).

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Expenses in Intercollegiate Athletics
Other Expenses *(continued)*

- **Salary and benefits for coaches and top-level administrators are quite sizable in all sports**
- **Size of staff has increased in scope**
  - **Growth in staff positions beyond traditional coaching and administrative roles**
  - **Carries additional salary expenses**
- **Smaller programs often outsource these activities if they cannot adequately staff due to lack of revenues**

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Expenses in Intercollegiate Athletics
Other Expenses *(continued)*

- **Team Travel**
  - **Expenses have increased as accommodations and plans have increased (e.g., charter flights, high-quality hotels).**
  - **Travel costs may be high due to lack of programs having those sport offerings (i.e., teams are forced to travel further)**
- **Equipment, Uniforms, and Supplies**
  - **Cost defrayed with partnerships with apparel and equipment companies**
- **Both directly tied to the number of programs offered**

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Expenses in Intercollegiate Athletics
Other Expenses *(continued)*

- **Facility maintenance and game expense**
  - **Stadiums and facilities are great sources of revenue, but are also major expenses**
  - **Cost associated with game day operations includes ushers, ticket takers, and security personnel**
  - **Multiple facilities for many sports including practice areas, strength and conditioning, academic support, sport medicine, and food services**

Expenses for a Sporting Goods Manufacturer

- Similar to those present in traditional businesses
- Products and services offered greatly affect expenses
  - Service—Labor
  - Product—Cost of producing good
- Fixed expenses—Costs that will not change as production changes
- Variable expenses—Costs that will change as production changes

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Expenses for a Sporting Goods Manufacturer *(continued)*

- **Cost of goods sold (COGS)—Materials, production, transportation, and royalty payments related to production of tangible product**
- **Selling, general, and administrative (SG&A)—Second-largest expense related to marketing and sales (e.g., sell goods to consumers as well as creating new products)**
  - **Employee costs come from SG&A**
- **10-K annual reports are great for finding information related to expenses for companies**

Expenses for Sporting Goods Manufacturer *(continued)*

- **Product Marketing: develop a strong strategy to entice the consumer to buy and promote their brand**
  - **Examples: advertising, media placement, corporate partnerships, and product endorsement, corporate partnerships**
- **Taxes: local, state, and federal fees collected from various activities (sales, ownership or property, and employing personnel)**
- **Payroll Taxes: Taxes collected from employee wages to support federal programs**
  - **Medicare, Social Security (FICA), federal payroll, and unemployment benefits**

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Expenses for Sporting Goods Manufacturer *(continued)*

- **Value Added Tax (VAT)—Tax collected at each stage of production or consumption of a good**
- **Debt Expenses for liabilities—Interest paid on debt in the current year to service all debt obligations by an organization**
- **Expenses are necessary to produce and sell products and services**

Other Expenses for Sports Organizations

- **Rent—Cost for physical space for which organization operates that they do not own**
  - **If owned, other expenses exist (e.g., interest, taxes, depreciation)**
- **Utilities—Electricity, heat, water, internet access**
- **Technology—Reduces office supplies spending (e.g., paper, copying, mailing), but may have significant up front costs**

Class Discussion Topics

1. **Develop a list of sources of expenses for a professional baseball team.**
2. **Develop a list of expense streams for a publicly traded sportswear company.**
3. **Develop a list of expense streams for a nonprofit health club.**
4. **Develop a list of expense streams for an intercollegiate athletic program.**

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Class Discussion Topics *(continued)*

5. **List and explain at least three exceptions that exist in the NBA collective bargaining agreement that permit teams to spend beyond the league salary cap.**
6. **Explain how free agency in professional sport has increased salary expenditures for professional sports teams.**
7. **Explain how increased technology has aided sports organizations in minimizing expenses.**

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Class Discussion Topics *(continued)*

8. **Explain the difference between the structure of American professional sports leagues' costs and expenses and European leagues' costs and expenses.**
9. **Explain the objectives of a collective bargaining agreement and how it serves the owners and players of a league.**
10. **Explain how the NCAA supports college athletics funding. How are athletic departments able to cover expenses when they are losing revenue?**

Part II Case Study Discussion Topics

1. **What revenue category (or categories) do you think needs to be added to the master chart of accounts to reflect the new economy (i.e., how business is conducted) and new technologies?**
2. **What expense category (or categories) do you think needs to be added to the master chart of accounts to reflect the new economy (i.e., how business is conducted) and new technologies?**

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Part II Case Study Discussion Topics *(continued)*

3. **If you had the responsibility of increasing revenues, what revenue category do you think you could realistically increase by 20% in one year and how? Think about the possible consequences (positive and negative) of taking actions to increase revenue, such as how selling more tickets incurs more selling expenses.**
4. **If you had the responsibility of decreasing expenses, what expense category do you think you could realistically increase by 20% in one year and how? Think about the possible consequences (positive and negative) of taking actions to decrease expenses, such as how reducing salaries decreases morale and possibly reduces future revenues.**